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FM AMEMBASSY ISLAMABAD
TO RUEHC/SECSTATE WASHDC 4372
INFO RHEFDIA/DIA WASHINGTON DC
RHEFSNG/HMSNG WASHINGTON DC
RUZDHTR/HOTR WASHINGTON DC//USDAO ISLAMABAD PK//
RUWSMXI/AMC INTEL CEN SCOTT AFB IL//INO/J2-J//
RUEPVAA/CDR JSOC FT BRAGG NC//J2/HSE//
RHMFISS/CDR USCENTCOM MACDILL AFB FL//CCJ2-JCH/HSE//
RHLFABN/CDR USESUCOM ABNCP VAIHINGEN GE//ECJ2/ECJ3/ECJ5-A//
RHMFISS/CDR USSOCOM MACDILL AFB FL//SOJ2/HSE//
RHMFIUU/CDR USTRANSCOM TCJ2 SCOTT AFB IL
RHMFISS/CDRUSAREUR HEIDELBERG GE//AEAGB-IAD//
RUEAIIA/CIA WASHINGTON DC//DDI/OEA//
RUEPVAA/COMJSOC FT BRAGG NC
RHMFIUU/COMSOCCENT MACDILL AFB FL//SOCJ2/HSE//
RHEFDIA/DIA WASHINGTON DC//DHO-3//
RHEFDIA/DIA WASHINGTON DC//MIO-4//
RUETIAA/DIRNSA FT GEORGE G MEADE MD//M112/S2132HT//
RHCKJAC/JAC MOLESWORTH JCDX RAF MOLESWORTH UK
RUEKJCS/JOINT STAFF WASHINGTON DC//J2/J5-EUR//
RUZFNAI/NASIC WRIGHT PATTERSON AFB OH
RUZFNAI/NASIC WRIGHT PATTERSON AFB OH//DEKA/FCTP//
RUZFNAI/NASIC WRIGHT PATTERSON AFB OH//DXOA/TAAO//
RHEFNGB/NGIC INTEL OPS CHARLOTTESVILLE VA
RHEFNGB/NGIC INTEL OPS CHARLOTTESVILLE VA//IANG-CE-CM/IANG-GS-AA//
RHEFNGB/NGIC INTEL OPS CHARLOTTESVILLE VA//IANG/CE/CECM//
RUCXONI/ONI WASHINGTON DC//32/211//
RUEALGX/SAF WASHINGTON DC
RUEKJCS/SECDEF WASHINGTON DC//USDP-ISA-ADMIN//
RULWAAM/STRATCOM IDHS-90 OFFUTT AFB NE//J22123//
RUEPGAA/US SURVEY DIV SHAPE BE
RUMICEA/USCENTCOM INTEL CEN MACDILL AFB FL
RUEHIL/USDAO ISLAMABAD PK
RUCQSAB/USSOCOM INTEL MACDILL AFB FL
RUEHLO/AMEMBASSY LONDON 1134
RUEHNE/AMEMBASSY NEW DELHI 5370
RUEHBUL/AMEMBASSY KABUL 0762
RUEHLH/AMCONSUL LAHORE 7747
RUEHKP/AMCONSUL KARACHI 2143
RUEHPW/AMCONSUL PESHAWAR 6737
RUEHRC/DEPT OF AGRICULTURE WASHDC
RUEATRS/DEPT OF TREASURY WASHDC
RUCPDO/DEPT OF COMMERCE WASHDC
RHEBAAA/DEPT OF ENERGY WASHDC

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SENSITIVE
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SUBJ: BI-WEEKLY REPORT ON ECONOMIC ISSUES, 12 AUGUST 2009

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TOP STORIES
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[1](#)1. (SBU) The International Monetary Fund (IMF) approved an additional USD 3.24 billion for Pakistan and increased the country's Special Drawing Rights (SDR) from 500 percent to 700 percent, pushing total assistance up to USD 11.33 billion from USD 7.6 billion. The IMF completed its second review of Pakistan's economic performance and extended the Stand-By-Arrangement (SBA) through [1](#)2010. The Fund has agreed that Pakistan can use a portion of the new funding to finance priority spending until the disbursements of donor support pledged for 2009-2010 are received. Pakistan would also benefit from the proposed allocation of Special Drawing Rights, which, once approved, would supplement its reserves. (Comment: The additional amount committed by the IMF will relieve pressure on Pakistan's budget. The IMF funding will help cover the expected

shortfall in tax collection due to an economic slowdown, increased costs for IDPs and "delays" in the Friends of Democratic Pakistan pledged funds releases.)

¶2. (SBU) In its August review, the IMF lowered its GDP growth estimate for the country for FY 2009-2010 from 3.3 percent to 3 percent noting that Pakistan's growth has been slow, especially in the manufacturing sector. The agriculture sector, buoyed by a bumper wheat crop, helped maintain positive GDP growth. Inflation, particularly for food, has continued to decline, though it still remains high with core inflation at just below 16 percent in June ¶2009. The exchange rate has been relatively stable in recent months, and international reserves increased to USD 8.3 billion in July, compared to USD 3.5 billion at end-October 2008. The GOP continues to predict 3.3 percent GDP growth for this current fiscal year. (Comment: Industrial growth will remain a drag on the GDP growth rate in FY 2009-2010 as it will be a difficult task to reverse the negative 8 percent growth rate from the last fiscal year to the GOP project 1.8 percent for this current fiscal year.)

¶3. (SBU) Advisor to the Prime Minister on Finance Shaukat Tarin was elected senator (unopposed) and sworn into office on August 7, elevating him to the title of Federal Minister of Finance. Syed Naveed Qamar replaced Dr. Asim Hussain as the new Minister of Petroleum and Natural Resources also on August 7. Qamar will be dual-hatted, retaining his current post of Minister of Privatization.

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¶4. (SBU) According to Dawn, the federal government borrowed Rs 121.7 billion (USD 1.5 billion) for budgetary support during the first three weeks of current fiscal year 2009-10 to cover rising expenditures and a shortfall in revenue collection due to slow economic activity in the country. FBR collected Rs. 74.077 billion (USD 892 million) during July 2009 against the target of Rs. 78 billion (USD 940 million), reflecting a shortfall of Rs. 3.923 billion (USD 47 million). (Comment: The increased borrowing from the banking system is likely to crowd out private sector credit, which will negatively affect private sector growth, particularly in manufacturing.)

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BANKING AND FINANCE
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¶5. (SBU) On August 1, The News reported that the State Bank of Pakistan (SBP) signed a Memorandum of Understanding (MOU) with Tameer Microfinance Bank (TMB) stating that the SBP will provide Rs. 82 million (USD 988,000) to TMB for one year. State Bank Governor Syed Salim Raza commented that the facility would help TMB launch branchless banking operations and build its institutional capacity. The SBP has developed a National Microfinance Strategy which is expected to provide microfinance outreach to 3 million clients by 2010 and 10 million by 2015. The strategy is intended to enhance the microfinance sector's sustainability and help it raise its capital base and human resource capacity. (Comment: A Tameer Bank official confirmed the article and applauded the State Bank Governor's efforts at enhancing microfinancing facilities.)

¶6. (SBU) On July 31, State Bank Governor Syed Salim Raza called for commercial banks to increase lending to the private sector in order to stimulate the economy, according to The News. Speaking at the Private Sector Credit Advisory Council (PSCAC), Raza commented that liquidity in the banking system has never been as high as it is today and noted that growth in non-performing loans (NPLs) has slowed in the last quarter of 2008-09. During fiscal 2007-08, overall private sector credit grew 16.5 per cent compared to an increase of only 0.7 per cent during 2008-09. This slowdown is attributed mainly to a dearth in economic activity in Pakistan coupled with the global recession. Loans for working capital declined 7.6 percent during FY09 for the textile, manufacturing, commerce and trade sectors; while fixed investment financing

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increased by 26.4 percent mainly for investment in manufacturing, electricity, gas, water, transport, storage and communication sectors.

17. (SBU) Import payments of furnace oil may put the Pakistani Rupee under pressure. From August 1 onwards, according to a recent SBP policy, all purchases of foreign exchange relating to the import of diesel and other refined petroleum products will be made by banks through the interbank market. This policy complies with the IMF condition that the SBP transfer the burden of foreign exchange for the import payment of diesel and other petroleum products to the banks. Banks will have to arrange approximately USD 450-500 million per month for the import payments which will put more pressure on the already depreciating Pakistani rupee against the dollar and euro due to high demand of the dollar in the interbank market. (Comment: Import of furnace oil and diesel has been in the private sector for some years now. A year ago the SBP took upon itself to arrange foreign currency for private oil importers. The IMF has now convinced the GOP to stop this practice and let private banks arrange foreign currency for oil importers. This will put pressure on the interbank foreign currency rates and the value of the Pakistani Rupee.)

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STOCK MARKET
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18. (SBU) The Karachi Stock Exchange KSE-100 Index closed at 8,044.5, after losing 37.56 points on Tuesday, August 11, 2009. Overall market capitalization slightly increased to USD 28.21 billion. Net foreign portfolio investment inflow was USD 18.6 million, the highest since April 2008. The outgoing week saw Lucky Cement posting better than expected results, which triggered positive movement in cement sector. Some blue chip results, such as MCB (Muslim Commercial Bank), PSO (Pakistan State Oil), Hubco (Hub Power company) and OGDC (Oil and Gas Development Corporation) will be released the week of August 17. The major stock players and bankers believe these results, coupled with the positive decision of the IMF to release and augment funds under Pakistan's Standby Arrangement, would set the tone for the market next week. The index is up 40 percent since the start of the calendar year but down 49 percent from its lifetime high of 15,676.34 on April 18, 2008. (Comment: Our KSE contact said the persistent inflow of foreign investment, prominent since the inclusion of Pakistan into the MSCI Frontier

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Index in May 2009, and the positive IMF decision to release further funds were the major driving forces that kept the optimism and provoked investors to stay at market with higher holdings.)

19. (SBU) The Lahore Stock Exchange (LSE) fluctuated day to day, but closed the two weeks ending August 8 where it began. Market capitalization was up 1.8 percent, and volume was average all month.

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TRADE
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10. (SBU) In the Federally Administered Tribal Areas (FATA) budget Rs. 5 million (USD 60,241) was allocated for Reconstruction Opportunity Zones (ROZs) in the FATA Annual Development Program (FADP) 2009-10. The FATA government also allocated Rs1.150 billion (USD 13 million) under the 2009-10 FADP for 44 projects focusing on small dam construction, mineral exploration, skill development, research and development, industries, housing, tourism and SME financing. (Comment: The allocation of Rs.5 million for ROZs shows the GOP's resolve towards ROZ legislation. However, government officials and businessmen both still maintain that the success of ROZs in the FATA crucially depends on the security situation.)

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ENERGY, POWER AND WATER
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¶11. (SBU) According to Water and Power Development Authority (WAPDA) data and media reports, the Punjab government dramatically reduced water releases from Mangla dam on July 23 in order to fill the reservoir for the province's irrigation needs. This move slowed Mangla hydroelectric production, which had already dropped the previous month due to mechanical failures. As rolling blackouts continue, the province denied an appeal from the federal government to release more water for power generation. The Mangla reservoir could take the rest of the month to fill. WAPDA figures show Tarbela reservoir climbed almost 3 feet per day over the last two weeks, despite substantial water releases for power and irrigation. It stands just 15 feet below capacity. (Comment: The Punjab government's decision to reduce Mangla dam water releases came one week after the Indus River System Authority (IRSA) rejected the province's request for more irrigation water through the

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Chashma-Jhelum link canal. IRSA advised the Punjab government to look to Mangla for additional irrigation supply so closing the Mangla tap for any other use appears to be the Punjab government's reply. Conflicts over hydroelectricity and irrigation are likely to intensify when summer snowmelt and monsoons end.)

¶12. (SBU) Extensive rolling blackouts continue to plague the country, but related civil strife has dissipated since the protests of late July. In a meeting with Consulate Lahore officials on August 6, Lahore Electric Supply Company (LESCO) officials blamed unscheduled load shedding on poor decisions by the national grid control center in Islamabad. The media covered dueling positions on the use of rental power plants to boost electricity supplies short term, while Prime Minister Gilani of the Pakistan People's Party (PPP) and Punjab Chief Minister (CM) Shahbaz Sharif of the opposition Pakistan Muslim League-Nawaz (PML-N) discussed the power crisis during a July 26 summit in Lahore. (Comment: The PPP led federal government has fared reasonably well in the public debate over rental power stations thanks to the PML-N's relative silence. In a July 28 meeting with A/PO, a PML-N official acknowledged the necessity of the federal government's short-term plan to utilize rental power.)

¶13. (SBU) On August 10, Dawn reported that China plans to put on hold the Coastal Oil Refinery Project at Gwadar in Balochistan. According to the media, China has formally informed the Government of Pakistan that there has been no progress on the Coastal Oil Refinery project; therefore, the project has been removed from the FY 2009-10 Financial Development Program between Pakistan and China. The proposed Coastal Oil Refinery, which was designed to reach a daily output of 60,000 barrels crude oil, was part of China's plan to invest USD 12 billion in multiple projects in Pakistan.

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BUSINESS
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¶14. (SBU) According to SBP data, foreign investors in Pakistan remitted USD 763 million abroad in FY 2008-09 despite low economic activity in Pakistan and the global economic recession. The

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repatriated amount during for FY 2008-09 was 17 percent lower than in FY 2007-08. Foreign investors repatriated USD 593.8 million from return on FDI in FY 2008-09 versus USD 673.3 million in FY 2008-09, a drop of 12 percent. The power sector registered the largest amount repatriated where foreign investors repatriated USD 184.4 million FY 2008-09 against USD 169.6 million in FY 2007-08, an increase of 9 percent. The financial services sector was second largest sector with USD 79 million remitted. Repatriation from trade, however, increased by 122 percent to USD 73.1 million from USD 32.8 million, while petroleum refining repatriation stood at USD 77.3 million with an increase of 40 percent. (Comment: The rise in

profits and dividend outflows in the last fiscal year despite a significant drop in FDI is the result of large FDI inflows in the past and is likely to continue despite the current decrease and slowdown in FDI inflows.)

PATTERSON